

EUI Working Paper RSC No. 96/27

The Role and Limits of
Active Labour Market Policy

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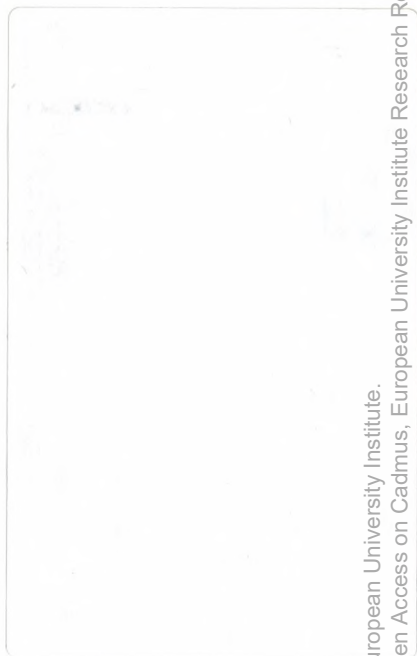


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ROBERT SCHUMAN CENTRE

**The Role and Limits
of Active Labour Market Policy**

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Introduction

In March 1996 the Employment Select Committee of the British House of Commons recommended the introduction, on a pilot basis, of a scheme to make all the long term unemployed an offer of a subsidised private sector job or, as a last resort, a state provided work placement in the community¹. The Committee claimed that if such a scheme was extended nationally long term unemployment could be reduced if not indeed virtually eliminated. Although the present UK Government would be unlikely to take such a proposal forward, an incoming Labour Government might take up the proposal. 'New Labour' has already proposed a similar scheme for the long term unemployed aged between 20-24.

This proposal was based in part on ideas put forward by two prominent academic economists², and it raises interesting issues to do with the role of economists in the framing of economic policy. These economists have argued for a 'systemic' change in the state's approach to long term unemployment, based on their judgement of the macro-economic impact of active labour market policy.

In particular the proposals build on the macro-econometric finding that the long term unemployed play no role in holding down wage inflation, so that an increase in their employment rates would generate no inflationary pressures. If employers used a wage subsidy to hire more of the long term unemployed at the expense of the short term unemployed or even by reducing their existing workforce, this would not matter. For a higher level of short term unemployment would reduce wage inflation, so allowing for an expansion of real demand, so that the workers who have been substituted against will all find work again, and relatively quickly before they become long term unemployed. When the subsidy or the placement on the community work programme finished, some of the previously long term unemployed participants might obviously find themselves unemployed again. But because they are now short term unemployed they too will place downward pressure on wage inflation, allowing for an expansion of real demand and an increase in employment sufficient to absorb them all.

Thus the whole economic rationale for this programme is based on one macro-econometric finding, that the long term unemployed play no role in holding down wage inflation, but that the rate of short term unemployment adjusts relatively quickly to its 'equilibrium' rate. This is not the place to discuss the nature of the work carried out, for example, at the Centre for Economic Performance at the London School of Economics, which has arrived at this finding³. However, it needs to be stressed that many economists, not least at the Centre for Economic Performance, doubt the robustness of the finding and some

believe that it is just plain wrong⁴. The questions to be posed are, firstly, whether the Employment Select Committee of the House of Commons has been told of these disagreements? And secondly, is it wise to proceed towards a 'systemic' change in the treatment of the long term unemployed in Britain, or elsewhere, based on a research finding which is so controversial?

The alternative route for thinking about the role of active labour market policy is to look carefully at the micro-economic evaluations of specific programmes. This should at least be a complimentary approach to the attempt to think about the impact of active labour market policy at a macro-economic level. Although macro-economic models can be used to suggest that countries which place heavy emphasis on active labour market policy may have a better outcome in terms of aggregate unemployment, these models cannot show what kinds of active policies might work best. Only micro-evaluations can tell us anything about the relative effectiveness of different active policies.

The aim of this paper is to place the case for active labour market policy as a solution to unemployment in the context of research on the effectiveness of actual programmes⁵. It is worth emphasising that in this field there are few, if any, new ideas. Almost everything has been tried before in some form or other, and in most of the advanced industrial countries. There are lessons - positive and negative - to be learned from this experience.

It should be clear from the title of the paper that one of the main conclusions is that we need to be realistic over what active labour market policy can and cannot achieve. There is always a danger of over emphasising the efficacy of any one instrument of policy in the debate over unemployment. Labour market programmes have a role to play, but a modest one.

Types of active labour market policy

Active labour market policy is a term which covers a number of programmes designed to improve the efficiency with which the labour market works, and to promote greater equality of opportunity in the labour market.

It is helpful to divide labour market programmes into four different types:

1) Measures to reduce mismatch

At the heart of active labour market policy lies the public employment service, with responsibility for matching jobseekers to notified vacancies, counselling those looking for work, enhancing the extent and quality of job search, placing some jobseekers in relevant employment programmes, and checking the eligibility of the unemployed to benefits.

2) Measures to raise the stock of skills

In most countries it is also the employment service which provides or purchases training places for the unemployed in order to reduce any mismatch due to an imbalance of skills in the labour market. Many countries also try to influence the incidence of training for those already in employment, though in practice few countries devote many resources to this end.

3) Measures to directly increase the demand for labour

This can be done either by providing temporary places in specific work programmes, usually with public or voluntary agencies, and offering low skilled jobs in such areas as environmental work or social and community services. Alternatively, the authorities can try to use incentives such as recruitment subsidies to try and encourage private employers to take on more of the unemployed⁶. It is this combination of measures to increase the demand for the long term unemployed which lie at the heart of current proposals in the UK.

4) Measures to promote equality of opportunity in employment

Most programmes tend to be skewed towards groups who are most likely to be marginalised in the labour market, such as the adult long term unemployed, the disabled and disadvantaged young people. Many governments have identified youth unemployment as a particularly serious political and social problem, so that youth programmes make up a significant part of the provision offered in most countries.

Active labour market policy in the OECD countries

The range of resources devoted to labour market programmes aimed at the unemployed varies significantly across the OECD countries (Figure 1). In 1992-93 Britain spent about one half of one per cent of GDP on such programmes, compared with over two per cent in Sweden, for example. Britain also spent less on 'passive' support for the unemployed (that is unemployment benefits) than in many other European countries, reflecting the relatively less generous rates of benefit paid in Britain when compared with, for example, the Netherlands.

Britain's spending on its employment service, at one fifth of one per cent of GDP, was in line with other countries. Britain spent significantly less than other countries on training schemes and direct job creation aimed at the unemployed.

Enthusiasm for active labour market policies was at its height in the late 1980s when many observers argued that such policies could 'pay for themselves'⁷. This was based on the observation that some smaller countries such

as Sweden, which devoted considerable resources to labour market programmes, also had significantly lower unemployment rates and therefore a smaller burden in terms of benefit expenditure. Unfortunately in the early 1990s this argument can no longer be sustained, as deep recessions in countries such as Sweden have resulted in very high rates of unemployment and consequently very high levels of spending on benefits (Figure 1). It is no longer possible to look at the patterns of spending on labour market programmes and benefits as shown in Figure 1 to demonstrate any clear case for active labour market policy.

The recent experience of countries such as Sweden also calls into question the strength of the argument that active labour market policies can improve the unemployment-inflation trade off by containing long term unemployment. The Swedish experience in the 1980s was held up to exemplify this - open long term unemployment was kept down by enrolling jobseekers onto labour market programmes and inflation remained moderate. However, in the early 1990s open short term unemployment in Sweden rose sharply and by 1994-95 was significantly higher than in the UK. Open long term unemployment was kept relatively low due to the dramatic expansion of schemes, but the outcome for inflation in Sweden was no different from in Britain.

In Britain since the late 1980s there has been a clear shift in resources away from training programmes and direct job creation towards the initiatives run by the Employment Service⁸ Over the period 1990-91 to 1993-94 spending on the Employment Service increased by nearly half in real terms. Spending on training programmes aimed at the unemployed fell by over a quarter in real terms, and spending on Youth Training fell by a third although this latter trend mainly reflected the increase in enrolment in full time education.

By 1994-95 the Employment Service in Britain was administering a battery of measures designed to improve placement services, assist job search and provide enhanced counselling for the unemployed (Table 1). Initiatives such as Jobclubs, Jobplan and Restart Courses offer similar provision, but aimed at different categories of the long term unemployed (for these three programmes, those out of work for six, 12 and 24 months respectively). This battery of measures is designed to provide a series of nets to catch the unemployed as they approach different durations of unemployment, and are as extensive as anywhere in the OECD.

What clearly distinguishes these Employment Service initiatives from training, work and youth programmes, and recruitment subsidies, is their significantly lower cost (Table 1). At a cost per place of £100-200 versus £2000-3000 for the more expensive measures, the latter would have to demonstrate significantly better outcomes in terms of participants successfully placed in work than the simpler initiatives, in order to justify their much greater cost.

The results of research on active labour market policy

Economic research has tried to assess how far different labour market programmes have significantly increased the chances of unemployed participants finding employment or higher earnings. It thus focuses on the economic effects of these programmes, though this is not to say that there may not be social benefits as well.

Simply recording the proportion of participants who obtain jobs at the end of a programme is in itself not very meaningful. Firstly, the 'job entry rate' is very sensitive to the economic cycle. More people leave programmes to enter jobs during periods of economic recovery than in periods of recession, but this tells us nothing about the quality of the programmes.

More fundamentally many unemployed people are finding jobs all the time, so that to note that a certain proportion of people leave a programme to enter jobs is in itself meaningless unless we can know what proportion would have found work anyway - the 'deadweight' of a programme. Also people on programmes may find work but only by 'substituting' for other jobseekers. Finally, direct job creation programmes may 'displace' work in other enterprises in the economy.

Economists have tried to model the impact of programmes in order to assess their effectiveness, taking into account the economic cycle, and deadweight, substitution and displacement effects. Surveys of participants or of employers and programme providers can also help to shed light on the performance of a programme.

However, the best way of taking into account the problem of 'deadweight' is to conduct an 'experiment' where unemployed people are randomly assigned into two groups - an 'experimental' group which benefits from the programme, and a second 'control' group which receives no assistance. The two groups are then compared over time to see whether those on the programme have found jobs at a significantly higher rate than the control group. Even this approach cannot tell us whether those in the experimental group have found work by substituting for other jobseekers.

Most of the research discussed in this paper comes from three countries: Britain, the United States (because this is where the best research has been conducted) and Sweden (because it is the country which has most heavily emphasised labour market programmes). Table 2 summarises both the results of research and the trade offs which have to be considered when addressing the case for these policies.

Measures to reduce mismatch - the Employment Service.

There is a stronger body of evidence on the beneficial effects of improved placement services and job search assistance on the subsequent job prospects of the unemployed than on any other component of active labour market policy.

The only classic experiment in Sweden to investigate the effects of a labour market programme followed four hundred individuals who had been out of work for over three months and were randomly assigned to an experimental group, which received intensified assistance from the Employment Service, and a control group with access to only normal assistance⁹. After one year, 55 per cent of those in the experimental group were in employment compared with only 42 per cent in the control group. The jobs obtained by the experimental group were significantly better paid, more likely to be permanent and involved more in-plant training.

An experimental approach was also used to investigate the effects of the Restart process in Britain¹⁰. It too came up with modest positive results, with 27 per cent of the Restart group in employment after 12 months compared with 23 per cent of the control group. Whether this was the result of the enhanced job search assistance and counselling offered by the Employment Service, or was the result of the impact of threatened benefit sanctions on those who did not demonstrate active job search, is a matter of some controversy. This illustrates the problem that although experimental approaches can help tell us whether a programme has worked, it might be a matter of further interpretation as to why it has worked.

Experimental approaches used to investigate the effects of offering improved placement assistance to mainly single mothers in receipt of welfare benefits in the United States have also demonstrated positive effects. These successful programmes have put heavy emphasis on active job search by participants¹¹.

Two critical points to stress about such programmes is that they are not very costly (Table 1), and they would seem to carry no risk of any adverse side effects.

Measures to raise the stock of skills - training programmes

Training the unemployed makes obvious intuitive sense. But it should be emphasised that finding convincing evidence for the beneficial effects of large training programmes is hard to come by. Perhaps the most extensive evidence comes from the United States. Single parents and unemployed people have been randomly assigned to, firstly, a group receiving additional assistance with job search, secondly, a group receiving job search assistance plus access to education and training programmes and thirdly, those receiving no additional assistance.

There have been modestly significant positive effects on subsequent employment and earnings for those receiving job search assistance but no additional positive effects for those who also received training¹². This suggests strongly that large scale training programmes offer no more benefits than would be attained from the far cheaper programmes run by the Employment Service.

The evaluations of training programmes in Sweden have generally produced ambiguous results. A review of the five most recent studies into the effects of training programmes in Sweden on subsequent earnings emphasised the wide range of estimates and the lack of convincing statistically significant positive results¹³. Experience in Sweden also shows how sensitive the 'success' of programmes is to the state of the cycle. In the booming late 1980s three out of four of those leaving training programmes in Sweden were going into jobs. In recession hit 1993 only one in four were finding work (compared with one in three in Britain on the Employment Training programme in this same year).

The OECD in its extensive review of international evidence found little support for the view that broadly targeted training programmes had significant beneficial effects¹⁴. However, smaller targeted programmes aimed at groups which only face moderate problems in the labour market may yield significant positive results. For example, a study found significant positive effects on subsequent earnings and employment for the relatively small scale Training Opportunities Programme (TOPs) which ran in Britain in the mid-1980s, and which at its peak offered some 80,000 places¹⁵. So an effective high quality training programme is likely to be relatively small in scale and to contribute little to any immediate reduction in headline unemployment. It is also likely to be relatively expensive. TOPs cost over twice as much per place as the current Training for Work programme in Britain.

It is worth asking why simple initiatives designed to enhance job search seem to be far more cost-effective than large training programmes? Surveys of employers constantly pick up concerns about the 'personal skills' and characteristics of job applicants, that is their motivation, ability to communicate and to get along with other employees, and so on. Generally the existence or not of those skills is a more important factor than possession of formal qualifications in determining recruitment, especially for the lower skill occupations¹⁶. Apparently simple interventions which have the effect of raising an individual's outward signs of motivation, or helping them to better compile a CV or handle an interview (which are the means by which an individual can best signal their possession of some of these 'personal skills'), might thus have a more significant effect on participants' job prospects than 'training' programmes.

Measures to increase the demand for labour - work programmes and recruitment subsidies

Research in Sweden has found that relief work in construction related activities results in very high levels of displacement of regular activity¹⁷. This is not true, however, of places in social and community schemes. However, in the more welfare orientated projects the work being performed was necessarily of marginal social value - this was the only way to ensure that the schemes were not displacing regular activity.

Traditionally there had been no Swedish research on the effects of participation on work programmes on subsequent employment. This was because such schemes were intended merely to tide people over until the regular labour market recovered and were not intended to have the effect of significantly boosting subsequent job prospects. However, more recent research argued that adult participants on Swedish work programmes appeared to search no more intensively for regular jobs than those already employed, and that participants were not significantly more likely to find work than the openly unemployed¹⁸. Results for the UK Community Programme which ran in Britain in the mid-1980s also showed no significant impact on the flows out of unemployment for participants¹⁹.

An economy which has very high unemployment is one which is likely to be running a large budget deficit, as in Britain and Sweden in the mid-1990s. Inevitably then any work programme will need to have a low cost per place, and in order to avoid displacing regular work will need to be at the margins of socially useful activity. Labour market programmes are instituted because of the shortage of regular employment opportunities. But in order not to interfere with the regular workings of the labour market, such programme places must not look or feel like regular jobs. They have to offer relatively low rates of pay so that the incentive to obtain a regular job remains. This was the paradox faced by the Community Programme in Britain in the mid-1980s. This kind of work programme will always represent a stop-gap, and indeed the recommendations made by the House of Commons Select Committee seemed to recognise this.

An evaluation based on questionnaires and interviews of employers of the effects of recruitment subsidies used in Sweden in 1978-9 and 1982 suggested that the net employment effect was very limited.²⁰ Most of the recruitment would have taken place anyway. The OECD in its review of the evidence found that the combined effect of deadweight, substitution and displacement for recruitment subsidies ranged between 76 and 95 per cent²¹. Other reviews also report that combined deadweight and substitution appear to range from 70 to 90 per cent of the gross number of jobs created by recruitment subsidies²².

The results of the evaluation of the Workstart pilots in Britain, which in part formed the basis for the House of Commons Employment Select Committee recommendations, are in line with this previous international experience²³. This programme offered a subsidy over one year of £2340 to employers willing to take on people who had been out of work for over two or four years. Finding placements involved considerable administrative effort and expense on the part of the Employment Service. Just under half the jobs 'created' were deadweight and another third involved employers substituting the long term unemployed for other jobseekers. As the authors point out this was the programme's intention. Recruitment subsidies do not create many new jobs. Rather their rationale is similar to that for the Employment Service programmes, that is the aim is to make a bigger share of employment opportunities available to especially disadvantaged jobseekers. So it makes sense for these subsidies to be administered by the Employment Service as an adjunct to other initiatives designed to improve job search. However, these subsidies are much more expensive than assistance with job search which would imply that their use has to be restricted to the most disadvantaged jobseekers, particularly the very long term unemployed.

Measures to promote equality of opportunity - Youth programmes

Politically and socially it is often youth unemployment which is seen as one of the greatest problems. The evidence from across the OECD is that the young are generally the most likely to benefit from a general upturn in the economy, just as they suffer most during economic downturns. Those unlikely to benefit immediately from a generalised expansion are those young people who tend to be relatively unqualified. Many will come from disadvantaged backgrounds, have had negative experiences at school and subsequently will have negative perceptions of state training or work programmes

This helps explain why many programmes aimed at the young unemployed have a poor track record. They are often targeting the 'hard core' of any age cohort. While attempts to draw such people back into the formal education and training system need to be made, in practice what they are most likely to respond to is some kind of work based programme, with a mix of off- and on-the-job training. This is an accurate description of much of the existing provision offered by Youth Training in Britain. However, YT does not pick up a small minority of the age cohort. What this minority seems to want are jobs, and most countries leave open the safety valve of work without training for a small minority of each age group. At times when the labour market is tight such jobs are likely to be available. But when unemployment is high the only option

is to be relaxed about the provision offered under any state 'training' scheme so that it can offer placements where the emphasis is definitely on the work rather than the instruction.

Conclusions: Designing an optimal active labour market policy

The recent movement of resources in Britain away from training and work programmes towards the initiatives run by the Employment Service is overwhelmingly backed by the results of research from across the OECD. Simple initiatives which offer improved placement services or assistance with job search can be shown to significantly boost participants' job prospects. The evidence for the effects of training and work programmes is much more mixed.

Training programmes which offer some chance of success should be relatively small but of high quality like the old Training Opportunities Programme in Britain which offered fewer than 100,000 places over a year. There is a separate issue of ensuring that unemployed people can undertake part time courses in mainstream further and higher education without threatening their benefit entitlement.

This training provision should be clearly separated from any work programme. There is a strong social case for having such a programme offering places for the most disadvantaged jobseekers. It is the kind of programme which could be easily expanded to counter the effects of a modest recession. But its economic benefits should not be exaggerated. In the context of a labour market in Britain which in the mid-1990s was seen to be generating, in the eyes of critics, too many temporary, part time, low paid and low skilled jobs, it would be a scheme offering temporary, probably part time, inevitably low paid and low skilled jobs. Like the old Community Programme it would offer a stop-gap, not a solution. The fact that the Community Programme continues to be regarded quite favourably is probably because it promised relatively little, unlike the over-hyped Employment Training programme which supplanted it.

The Employment Service should also have the option to use recruitment subsidies to help place the very long term unemployed, to be used alongside the other placement/job search/counselling initiatives. But their use would have to be kept to a minimum as they are potentially expensive and require considerable administrative effort to secure places. The UK's experience with its Workstart scheme is informative. Finding some 1500 places in just over a year in four areas during the Workstart pilot phase proved demanding. These jobs were overwhelmingly in very small enterprises. Grossing these 1500 places up to represent all the labour markets in Britain would suggest the scope for up to 35,000 places on a national scheme, of which up to half would represent new

opportunities for the very long term unemployed. This would be equivalent to about 3-4 per cent of those out of work for over two years in April 1995.

In Britain, the guarantee to provide a place on Youth Training for all 16-17 year olds has failed to reach a minority of each age cohort in Britain. There is a case for having more flexibility in the administration of such youth programmes so that more placements can be found for the most disadvantaged young people, even if those placements make less sense in labour market terms. This is to emphasise the 'social' function of programmes like YT. It should also be accepted that for a very small minority of each age group - perhaps 5-10 per cent - what they want is a job, and not education or training. This safety valve has to be kept open even if the numbers taking this route must be minimised by efforts to attract as many as possible into further education or training.

This list of policies looks decidedly uninspiring, especially when compared with the grand schemes offered by other academics. However, it is based on a realistic assessment of what active labour market policy can and cannot achieve, drawing on the evidence from micro-economic research on the effectiveness of different programmes. Some individuals have been able to grab the attention of policy makers with grandiose schemes, capable of being sold only to those not aware of the evidence on whether such schemes can be shown to work or not.

There are some clear issues here for economists. Firstly, are economists more confident about the results drawn from careful micro-economic studies including those employing experimental designs, or results drawn from macro-economic models or even purely theoretical approaches? Secondly, is it the job of economists to act as evangelists for particular policies, or to lay before the policy makers the whole range of evidence on the efficacy of a particular policy, making clear all the assumptions which lie behind the suggested impact of such policies, so that the policy makers can make up their own minds?

There can be a price to pay for exaggerating the role of labour market programmes, if it leads to the neglect of other policy instruments, and especially if such programmes are sold as offering a possible free lunch. In Sweden in the early 1990s over-confidence in the capacity of active labour market policy to contain unemployment contributed to errors in monetary policy which made the recession there much worse.

It might be time for active labour market policy to be seen as one of the more modest instruments of economic policy, which can make some contribution to improving the efficient operation of the labour market and to the delivery of social goals, but whose efficacy should not be exaggerated.

TABLE 1

The scale and cost of employment and training programmes in
England and Wales, 1994-95

Employment Service programmes

	Number of places	Cost per place
Jobclubs	257,000	£196
Jobfinders grants	4,700	£181
Job interview Guarantee	300,000	£6
Jobplan	250,000	£127
Job review workshop	40,000	£80
Job search seminar	65,000	£75
One-to-one	10,000	n/a
Restart courses	144,000	£98
Travel-to-interview	55,000	£40
Work Trials	20,000	£110
Workwise	10,000	n/a

Training programmes

Training for Work	280,000	£2475
Career Development loans	35,000	n/a
(In mainstream education)*	(80,000)	n/a

Work programmes

Community Action	50,000	£1860
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Recruitment Subsidies

Workstart	1,200	£2340 (not inc. admin. costs)
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Youth programmes

Youth Training	232,000	£2831
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Source: Employment Department Group: Departmental Report, 1995.

* Estimate from Labour Force Survey of the number of unemployed claimants enrolled in some kind of part time education course.

TABLE 2
The trade offs in active labour market policies aimed at the unemployed

Policy	Benefits for the unemployed	Gross costs per place	Comments
Employment Service: placement assistance & job search	Significant, but modest in scale. Can benefit target group at expense of others.	Very Low	Work better in relatively tight labour markets.
Training programmes	Hard to substantiate for large programmes. Modest significant effects for smaller programmes.	High for quality might programmes	Small, high quality programmes be effective, but are expensive. Will make little contribution to reducing headline unemployment.
Work programmes	Benefits while on program, but little effect on subsequent job prospects.	Moderate	Has to offer a moderate cost per place to accommodate large numbers. By definition work of marginal social value.
Recruitment subsidies	Net employment effects small. Can benefit target group at expense of others.	Depends on scale of subsidy	Work better in relatively tight labour markets. Require considerable administrative effort to find places.
Youth programmes	Can 'mop-up' some youth unemployment. Effects on subsequent job prospects uncertain.	High for quality programmes	Programmes deal with the most disadvantaged young people who are sometimes antipathetic to state schemes.

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2. Snower, D. (1994), 'Converting unemployment benefits into employment subsidies', Discussion paper No. 930, Centre for Economic Policy Research, London.
Layard, R., (1995), 'Preventing long term unemployment in Europe', Working paper No. 565, Centre for Economic Performance, London School of Economics.
3. Layard, R., Nickell, S. and Jackman, R. (1991), 'Unemployment: Macroeconomic performance and the labour market', Oxford University Press, Oxford.
4. Most notably Blanchflower, D. and Oswald, A. (1994), 'The Wage Curve', MIT Press, Cambridge, Massachusetts, United States.
5. The paper is based on a report written for the Employment Policy Institute, 'The limits of active labour market policies', Employment Policy Institute Economic Report, Vol. 9, No 6, London.
6. The authorities can also provide subsidies to encourage the jobless to become self employed. In some countries, notably Sweden and the Netherlands, considerable resources are also devoted to helping the disabled into employment. For reasons of space these programmes are not discussed here.
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9. The Swedish research is discussed in Robinson, P., (1995), 'The decline of the Swedish Model and the limits to active labour market policy', Discussion Paper No. 259, Centre for Economic Performance, London School of Economics, August 1995.
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17. See note 13.

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21. See note 12.

22. Calmfors, L. (1993), 'Active labour market policy and unemployment - A framework for analysis of crucial design features', mimeo, Institute for International Economic Studies, Stockholm University.

23. Atkinson, J. and Meager, N. (1994), 'Evaluation of Workstart pilots', Institute for Employment Studies, Report no. 279.

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